THE ECONOMIC SITUATION

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•The economy forges ahead, with more steam than expected.
•Asian slowdown takes edge off manufacturing gains.
•South Carolina's economy continues to rack up gains.
•New age antitrust activists bring new chill in an age of global warming

The Mid-Year Economy

A Consumer-Driven Economy Forges Ahead

Showing a will of its own, the first quarter economy recorded 4.8% growth in GDP, outstripping 1997's final quarter's growth of 3.7%. Cheered by exceptional work opportunities and the durable bull market, optimistic consumers, have lined up to purchase new cars, major appliances, and other consumer goods. Retailers enjoying record sales are now found on brokers' lists of favorites for the year ahead. As John Harris notes in the Harris Letter, the stock market is now a part of the democratic experience, with equity investments nosing out housing as the largest category of consumer wealth. Fueled partly by equity line borrowing, consumers have placed their bets on the U.S. economy. So far, the bet has paid off.

At mid-year, practically all employment growth has occurred in services and trade. The May employment report left the unemployment rate at 4.3% and continued to show healthy job gains for the year. Until now 1998's employment growth, pulled down by early-year data, did not compare favorably with 1997 and 1996 when the monthly gains routinely averaged more than 250,000. April's gains of 302,000 workers and May's 296,000 suggest the economy is becoming stronger, not weaker. A similar reading is found in the Philadelphia Federal Reserve Bank's survey of regional manufacturers. The survey shows surging shipments, a stable level of unfilled orders, and weaker pressure on prices paid for inputs. But when it came to the outlook for the next six months, the respondents were less than optimistic. They see a weaker economy in the months ahead.

With the average workweek getting longer and hourly earnings rising at a 4.3% annual rate, workers are bringing home the bacon. When fast food stores start giving signing bonuses to new hires, we can be sure that labor markets are tight. As supply and demand come into balance, the economy can only grow as fast as labor supply and productivity gains allow. Even so, inflationary forces are still being held at bay, at least for now.

The Inflation Picture

Citibank's Economic Week offers a longer-term inflation picture to consider. Subtracting the yield on the Treasury's inflation-indexed bonds from the standard issue Treasury bonds of the same duration gives an estimate of investor-held inflation expectations. Applied to June 12 data, the exercise yields 1.88% as expected inflation over the next 10 years and 2.08% for the 30-year outlook. By comparison, CPI measured inflation is running at about 1.4% for the last 12 months. In other words, investors believe

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inflation will rise a bit in the years ahead. Keep in mind that these expectations are already factored into the interest rates on longer-term debt instruments, such as mortgages.

There is a deeper story to the inflation number that captures the difference between durable goods and services prices. As explained by Wake Forest University's Gary Shoesmith, prices for durable goods are actually lower now than a year ago, and sector wages are rising at a 3.3% clip. On the other hand, services pricing shows a fourth quarter 2.4% increase, and wages are rising 4.1%. In short, global goods competition and the Asian effect have significant effects on the goods sector, and not much effect on services.

Asia's Problems Affect U.S. Manufacturing

With investment in new plants moving at a solid pace, one might get the idea that Asia's problems just don't matter very much. But production, export, and manufacturing employment declines present a different picture. Exports are falling, and the surging dollar brings rising imports. This yields an inverted saucer describing 1998's economic growth. We are surging a bit now, but weaker growth seems to lie ahead. Translated into GDP growth, the numbers look like overall growth of 3% for 1998, with GDP at year-end hitting 2.5%.

Bargain dollar prices for Asian assets are yielding an increase in U.S. foreign investment, which also tips the balance of payments toward the deficit side of the ledger. Asia clearly matters, and among the troubled countries, Japan probably matters most. So far, the Japanese government has not come to grips with financial sector and other domestic problems. Their economy is sagging. At the same time, turmoil in other Asian countries is not getting much better. A long trip is in store for those who will travel from today's Asian problems to tomorrow's resumption of stable growth. Along the way, of course, assets will be repriced, and excess capacity in those quarters will translate into lower priced imports to the U.S.

Europe's recovery is countering some of the Asian weakness. While the UK is slowing a bit, Germany, France, and other European economies are moving forward. Indeed, when one compares stock market growth worldwide, the gains in European markets make some of the U.S. numbers look a bit pale. This gives comfort to some investors who hear talk of U.S. equities being overpriced.

South Carolina and the Region

South Carolina continues to rack up a strong 1998. In spite of employment weakness in manufacturing, total state employment is growing at an annual rate of 4.2%, the fastest clip since 1988. With significant announced plant expansions and a surging trade sector, the state is showing healthier personal income growth than in year's past, 4% in 4Q1997, which rivals that of Georgia with 4.8% growth in the region's stronger state economy. However, unlike Georgia and North Carolina, the state is registering a decline in manufacturing employment. A surging trade sector more than compensates for the decline in manufacturing employment, at least in number of jobs. And the state ranks second in the region in employment growth in the financial sector.

The recently announced BMW expansion illustrates how the manufacturing sector is being transformed. The plans for 1,000 added jobs at wages close to $18 per hour translates to $37 million in annual wages. If the jobs represented a net increase for the state, the multiplier yield would translate the $37 million to $74 million in total effect. Most likely, just part of the 1,000 new worker will be net new arrivals. Still, the marginal effect significantly dampens the losses still be recorded in layoffs and plant closings in the apparel sector. Since January, textile and apparel plant closings and layoffs have eliminated some 2,400 jobs, with 410 associated with the Sara Lee's recent closing in Florence.

Columbia's newly announced prisoner hospital illustrates growth in the services sector. Just Care, Inc., an Alabama company that operates private hospitals, plans to spend $15 million to renovate one of the older mental hospitals to serve prisoners from the Carolinas and Georgia who require constant care. When operating in full force, the hospital will have a staff of 250, including doctors, nurses, and administrators. The BMW and Just Care announcements may seem poles apart, but illustrate the diversity and vibrancy of the state economy.

Housing starts and sales are surging in major state metropolitan areas, with March residential permits rising 15.2% over the 1997 level. The Columbia area seems to be leading the pack, with unit sales rising 54% in March. By comparison, the Greenville area saw a 10.4% increase in the same month. The booming housing market is reflected in surging construction employment, now at the highest level since 1990.

Data on imports and exports through the Port of Charleston present a picture of what is happening to the national economy. In March, imports were almost 22% higher than the previous year's figure. Exports were up, but by just 7.4%. Tourism this year, measured by accommodation tax revenues, was at about the same level as 1996 and 1997 for Horry County, but 22.7% higher for Charleston County, which is now one of the most vibrant smaller economies in the state.

The Antitrust Dragon Slayers

Since the early 1980s, U.S. antitrust enforcement has experienced major changes. Part of the change reflected what is called "the new learning" in antitrust economics. After poring over lots of data and stories, the economists learned that competition mattered most, not firm size or share of market. As long as markets are open, monopolies, if they arise, will be temporary. The new learning caused the FTC and the U.S. Department of Justice to revise procedures, enforcement practices, and to close a number of major cases, like the ones against IBM and AT&T.

The last two years has witnessed a move to the old learning. With cases now pending against Intel and Microsoft, the two firms that did more than any others to assist the development of the new information economy, we are now told that share of market matters. Perceived abuses of market power, even if temporary, will be challenged by government, especially for firms that have been "too successful" in serving consumers.

Of course, the Microsoft story is extraordinarily complex, but suggesting that the firm should avoid the economies and consumer convenience of providing completely integrated software compares with requiring auto companies to allow consumers to select the brand of radios, CD players, and air conditioners that would then be installed by dealers or relayed in special orders to the factory. Surely, the now defunct add-on air conditioner firms that brought cool air to cars in 1950s would have liked the idea, as would a multitude of electronic goods producers. But, competition for fickle consumers led to today's integrated automobile just as it has to the personal computer.

Fraud, deception, and collusion, on the other hand, pose situations where the federal police can and should pursue the culprits. But builders of better mousetraps that bring the market to their door should be allowed to enjoy the fruit of their hard work and imagination. High profits always attract competition and even better mousetraps.

Final Thoughts

This past February, Julian L. Simon, a University of Maryland economist and staunch believer in the unlimited powers of free people to create wealth, died at the age of 65. Simon gained notoriety when he placed a bet with doomsday prophet Paul Ehrlich in the 1980s that any bundle of commodities Ehrlich might pick would be cheaper 10 years later. The payoff would be based on the difference in the price of the bundle. Ehrlich, who had written about $100 per barrel oil and the hopeless state of mankind, gladly took the bet. Needless to say, Ehrlich lost. But he remained convinced that it was just a matter of time.

Simon believed that human beings were the ultimate resource, that the minds of free men and women can accomplish miracles when given freedom in a market

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economy. If oil becomes scarce and dear, the free spirit of mankind, if given market incentives, will find and develop substitutes. His book, The Ultimate Resource, spelled out the story.

Today, when President Clinton announces the end of big government, it is far easier to be a friend of free markets than it was in the 1980s, when presidents and others saw catastrophes around every corner. But tales of global warming, plans for Heritage Rivers, attacks on successful firms, and efforts by government to form profit-sharing cartels with tobacco companies remind us that free markets are never really free. Men and women like Julian Simon have more than faith in markets. They know the facts about markets.

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